

Decision **DRAFT DECISION OF ALJ BARNETT** (Mailed 7/18/2005)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of SOUTHERN CALIFORNIA
EDISON COMPANY (U-338) For Approval of Its
Methodology for Allocating Its AB1X Generation
Revenue Shortfall.

Application 05-03-025
(Filed March 28, 2005)

OPINION GRANTING APPLICATION

Southern California Edison Company (SCE) seeks approval of its proposed methodology for allocating the generation revenue shortfall resulting from Resolutions E-3895 and E-3897. In those resolutions we determined that revenues that cannot be recovered in SCE's Tier 1 and Tier 2 residential rates due to limitations in Assembly Bill 1X (AB 1X), as codified in Water Code Section 80110, cannot be recovered in Tier 3 and Tier 4 residential rates until the Commission makes a policy decision on the issue.

I. Summary of SCE's Allocation Proposal

SCE's application presents a proposal for allocating the generation revenue shortfall resulting from AB 1X's limitations on rate increases for certain usage by residential customers. SCE proposes to eliminate the inter-class subsidies caused by AB 1X's restrictions if any of the revenue shortfall were to be recovered from other customer classes. The proposal ensures that residential customers pay an equitable share of the costs SCE incurs to serve them.

SCE's proposal also provides a mechanism for disposing of existing balances in tracking accounts authorized in Resolutions E-3895 and E-3897.

SCE's proposal includes a residential rate design methodology that would set Tier 1 and Tier 2 energy rates for residential customers taking service on Schedules D and D-CARE at the maximum level allowed by AB 1X when rate changes are authorized by the Commission or the Federal Energy Regulatory Commission (FERC). Tier 3 and/or Tier 4 rates would then be designed to recover the remaining revenues allocated to the residential customers.

A. Background

As a result of the 2001 California energy crisis, we adopted a 3 cents/kWh surcharge applicable to the energy usage of all SCE customers. (See Decision (D.) 01-05-064.) Although D.01-05-064 stated that the rate increase applied to all customer classes, we acknowledged that Water Code Section 80110 limited our ability to increase energy rates for a certain amount of residential customer usage. Water Code Section 80110 states in relevant part:

In no case shall the commission increase the electricity charges in effect on the date that the act that adds this section becomes effective for residential customers for existing baseline quantities or usage by those customers of up to 130 percent of existing baseline quantities, until such time as the department has recovered the costs of power it has procured for the electrical corporation's retail end use customers as provided in this division.

In view of Water Code Section 80110's restrictions, we noted that we could not increase the Tier 1 and Tier 2 energy charges for residential customers' usage below 130% of their baseline allowances. We allocated the resulting revenue deficiency equally among three customer classes: residential, commercial, and

industrial.¹ We subsequently issued several additional rulings concerning the allocation of SCE's AB 1X revenue shortfall. On January 27, 2005, we ordered SCE to file the instant application to address the final allocation of the revenue shortfall resulting from the AB 1X limitations.²

In summary, SCE is currently recording the revenue impacts of AB 1X limitations on Tier 1 and Tier 2 residential rates in three different ways:

1. Unrecovered generation revenues from residential non-CARE customers due to the FERC-Jurisdictional Reliability Services Balancing Account Adjustment (RSBAA) rate increase recorded in a sub-account of the Residential Generation Revenue Shortfall Memorandum Account (RGRSMA) (estimated annual amount of about \$10 million);
2. Unrecovered generation revenues from CARE customers due to the RSBAA rate increase recorded in the CARE balancing account (estimated annual amount of about \$3 million); and
3. Generation revenues recovered through Tier 3 and Tier 4 residential rates due to the Phase 1 of 2003 GRC Distribution rate increase tracked in a sub-account of RGRSMA (estimated annual amount of about \$62 million).

SCE's proposal for allocation of its generation revenue shortfall is described below.

¹ D.01-05-064, pp. 25-26.

² Resolution E-3895, Ordering Paragraph 1.b., p. 19.

**B. SCE's Proposal for Disposition of the
AB 1X Generation Revenue Shortfall and
for Handling Increases and Reductions in
Revenues Allocated to Residential
Customers in Various Tiers of Schedules D
and D-CARE Going Forward**

Cost-based revenue allocation principles provide that each rate group should be responsible for the revenues allocated to it. Consistent with theory, SCE argues, residential customers should pay for any revenue shortfall resulting from AB 1X limitations on increases to Tier 1 and Tier 2 residential rates. Those shortfalls should be recovered through higher Tier 3 and/or Tier 4 rates. Absent such a treatment, cost allocations to various rate groups in any given rate design proceeding deviate from principle. For example, in Phase 2 of its 2003 GRC, SCE worked with all active parties to reach a settlement on the amount of revenues to be allocated to each of its 13 rate groups. The settlement was the product of many compromises and moved the residential CARE and non-CARE customers' average rates closer to the cost of providing service to them, while considering the bill impacts on these customers and the preservation of a sufficient level of discount under the CARE program. We approved the settlement in D.05-03-022.

On April 14, 2005, SCE implemented the settlement in conjunction with the revenue requirement changes adopted in its 2004 Energy Resource Recovery Account (ERRA) proceeding (see D.05-03-006), and the decision in the Department of Water Resources (DWR) revenue requirement allocation proceeding (D.05-03-024 or its successor). If any revenue increases to SCE's residential customers resulting from these proceedings cannot be recovered in Tier 1 and Tier 2 residential rates, and if the shortfall is not recovered in higher Tier 3 and/or Tier 4 rates, but is shifted to other rate groups, then the balance

achieved in the Phase 2 GRC settlement will be removed even before it is implemented.

SCE recognizes that faced with the energy crisis and a significant rate increase in excess of 3 cents/kWh, in D.01-05-064, the Commission decided that it was appropriate to allocate two-thirds of the revenue shortfall to non-residential customers. However, a crisis atmosphere no longer prevails. Future rate increases will most likely not approach those adopted in D.01-05-064. Thus, in its view, we need not shift costs incurred to serve residential customers to other customer classes.

**C. Proposed Disposition of Existing Balances
in the RGRSMA and the CARE Balancing
Accounts**

SCE proposes to eliminate the sub-account of the RGRSMA established in compliance with Resolution E-3895. This sub-account tracks the revenues associated with the implementation of rates proposed in Advice 1808-E, and any other similar revenues resulting from any future rate changes adopted by us prior to our final decision on this application. The current revenues recorded in that sub-account represent the amounts that would have been collected in Tier 1 and Tier 2 rates of Schedule D, absent AB 1X limitations. Those amounts have appropriately been recovered in Tier 3 and Tier 4 of Schedule D from the residential non-CARE customers since August 4, 2004. If SCE's proposal is adopted, there is no need for further tracking of such revenues as they should continue to be recovered from the residential non-CARE customers to prevent cost shifting.

SCE also proposes to continue recording the revenue shortfall from residential non-CARE customers created in compliance with Resolution E-3897 (an estimated annual amount of \$10 million) in the relevant sub-account of the

RGRSMA until the first consolidated rate change after our approval of SCE's proposal in this application. At that time, SCE will assign the balance in this sub-account to the residential non-CARE customers to be recovered along with other revenue allocation changes to these customers. In such a consolidated rate change proceeding, Schedule D energy charges by tier will be designed in accordance with the methodology described in Section D below and this RGRSMA sub-account will be eliminated.

SCE also proposes to continue recording the unrecovered generation revenues from CARE customers created in compliance with Resolution E-3897 (an estimated annual amount of \$3 million), in the CARE Balancing Account, to be recovered from all (excluding CARE and Street Lighting) customers, consistent with the current treatment of that account's balance. Schedule D-CARE energy charges will be established at the levels resulting from the consolidated implementation of D.05-03-022 in Phase 2 of SCE's 2003 GRC proceeding, D.05-03-006 in SCE's ERRRA proceeding, and D.05-03-024 or its successor, in DWR's 2005 revenue requirement allocation proceeding. No additional revenue under-recovery would accrue to the CARE Balancing Account starting April 14, 2005.

This treatment is made possible by the introduction of a third tier for Schedule D-CARE as a result of D.05-03-022 because any revenue shortfall due to the AB 1X limitations on the Tier 1 and Tier 2 D-CARE rates can now be recovered in the third tier energy charge of that schedule. SCE states that it is appropriate to recover any revenue shortfall accrued prior to April 14, 2005, from all (excluding CARE and Street Lighting) customers because the Commission-adopted treatment in Resolution E-3897 resulted in a larger discount to the CARE customers and all other customers have historically paid for that discount.

Furthermore, because we did not issue a final decision on this application by April 14, 2005, SCE established a separate sub-account of the RGRSMA to record the amounts recovered in the third tier of Schedule D-CARE due to AB 1X limitations, which will now be eliminated.

D. Proposed Residential Rate Design Methodology

To comply with AB 1X, Tier 1 and Tier 2 rates for Schedules D and D-CARE will be established at the maximum level allowed by AB 1X. If there is an increase in any unbundled rate component applicable to these customers, SCE will implement that rate increase by increasing the appropriate rate component for all tiers. However, because this would violate AB 1X, SCE will reduce the Tier 1 and Tier 2 SCE Generation rate components commensurately to maintain the total Tier 1 and Tier 2 rates at the maximum levels allowed by AB 1X. Any SCE Generation revenue under-collection will then be recovered from Tier 3 and/or Tier 4 rates in proportion to the SCE Generation revenue recovery from those tiers.

If there is a reduction in any unbundled rate component applicable to these customers, SCE will implement that reduction by reducing the appropriate rate component for all tiers. This would reduce the total Tier 1 and Tier 2 rates below the maximum levels allowed by the AB 1X. SCE proposes that the Tier 1 and Tier 2 SCE Generation rate components then be increased commensurately to maintain the total Tier 1 and Tier 2 rates at the maximum allowed levels. Any SCE Generation revenue over-collection will then be used to reduce Tier 3 and/or Tier 4 SCE Generation rates in proportion to the SCE Generation revenue recovery from those tiers. We agree with this approach, which is in compliance with AB 1X, with one caveat, which is discuss below.

II. TURN's Protest

TURN is concerned with statements such as “residential customers should pay for any revenue shortfall resulting from AB 1X limitations on increases to Tier 1 and Tier 2 residential rates.”³ Taken out of the context of the specific relief sought by SCE in this application, such a statement suggests that the Commission should adjust inter-class revenue allocation in the future to shift additional costs to the residential class. If the Commission were to agree with such a statement in its decision approving SCE's application, other parties may be left with the impression that this set of changes could justify future cost allocation outcomes. In order to avoid this type of misperception, TURN recommends that we should clarify that approval of SCE's application is limited to the specifically enumerated rate changes and does not provide a mandate for any particular future inter-class cost allocation adjustments. TURN does not object to the substance of SCE's application.

We agree with TURN that clarification is needed. We will accept SCE's proposal as to how it will deal with AB 1X in any matter properly filed by advice letter until the next time that the Commission considers the appropriate rate design for SCE in a revenue allocation, rate design, or GRC proceeding. This covers both how SCE will deal with allocating any shortfall that would otherwise occur due to the AB 1X limitations, as well as how SCE will deal with the situation where a rate decrease properly filed by advice letter would otherwise result in a Tier 1 or Tier 2 rate below the AB 1X maximum. This approval, is *not* intended to establish any binding rule as to how the Commission will deal with

³ Testimony of Akbar Jazayeri, p. 6, lines 5-6. This statement is also contained in SCE's application, p. 3.

any matters for which a formal application is required. Our authorization to SCE should not have any bearing on the initial allocation of cost responsibility to the residential class as a whole.

III. Categorization and Need for Hearings

In Resolution ALJ 176-3036 dated April 6, 2000, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. There is no apparent reason why the application should not be granted. Given these developments, a public hearing is not necessary, and it is not necessary to disturb the preliminary determinations.

IV. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. No comments were filed. We have clarified the discussion of limiting the effect of SCE's proposal.

V. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Robert Barnett is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The proposal described in this application is limited to the allocation of the revenue shortfall associated with the rate restrictions in AB 1X.
2. Tier 1 and Tier 2 energy rates for residential customers taking service on Schedules D and D-CARE should be set at the maximum level allowed by AB 1X when rate changes are authorized.
3. Tier 3 and/or Tier 4 rates should be designed to recover the remaining revenues allocated to the residential customers.

4. SCE should eliminate the sub-account of the RGRSMA established in compliance with Resolution E-3895.

5. SCE should continue recording the revenue shortfall from residential non-CARE customers created in compliance with Resolution E-3897 (an estimated annual amount of \$10 million) in the relevant sub-account of the RGRSMA until the first consolidated rate change after this decision. At that time, SCE will assign the balance in this sub-account to the residential non-CARE customers to be recovered along with other revenue allocation changes to these customers. At that time the RGRSMA sub-account will be eliminated.

6. SCE should continue recording the unrecovered generation revenues from CARE customers created in compliance with Resolution E-3897 (an estimated annual amount of \$3 million), in the CARE Balancing Account, to be recovered from all (excluding CARE and Street Lighting) customers, consistent with the current treatment of that account's balance.

7. No additional revenue under-recovery should accrue to the CARE Balancing Account starting April 14, 2005. Any revenue shortfall accrued prior to April 14, 2005, should be recovered from all (excluding CARE and Street Lighting) customers. Then the RGRSMA account should be eliminated.

8. If there is a reduction in any unbundled rate component applicable to these customers, SCE should implement that reduction by reducing the appropriate rate component for all tiers. Should the total Tier 1 and Tier 2 rates be reduced below the maximum levels allowed by the AB 1X, the Tier 1 and Tier 2 SCE Generation rate components should be increased commensurately to maintain the total Tier 1 and Tier 2 rates at the maximum allowed levels. Any SCE Generation revenue over-collection should then be used to reduce Tier 3 and/or

Tier 4 SCE Generation rates in proportion to the SCE Generation revenue recovery from those tiers.

Conclusions of Law

1. SCE's methodology for accounting its AB 1X generation revenue shortfall should be approved because it is reasonable and consistent with the requirements of AB 1X.
2. The approach delineated in this decision is appropriate for implementing rates that have already been adopted for the residential class. It should not apply to the initial allocation of cost responsibility to the residential class as a whole.
3. This decision should be effective today.

O R D E R**IT IS ORDERED** that:

1. Southern California Edison Company's (SCE) methodology for allocating its Assembly Bill 1X (AB 1X) generation revenue shortfall, as described in the findings of fact, is approved.
2. In regard to AB 1X, the methodology authorized in Ordering Paragraph 1 shall be in effect for any matter properly filed by advice letter until modified by the Commission after the Commission considers SCE's rate design in a revenue allocation, general rate case, or other rate design proceeding.
3. Application 05-03-025 is closed.

This order is effective today.

Dated _____, at San Francisco, California.